Financial Services and Egypt's Commitments in the GATS

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Executive Summary

Global trends in financial services—diversification, specialization, and integration, and the rising expectations for financial services these trends generate—have profoundly affected international and domestic financial markets, individual firms, and regulatory institutions. Another driver of global trends in financial services is the General Agreement on Trade in Services (GATS).

A founder of GATS in 1995, Egypt has continued its reform and liberalization program begun in 1991. Although it has penetrated all financial sectors, the program has failed to invigorate competition, open new markets, or broaden access to capital on the scale required for accelerating Egypt's growth. The uneven implementation of liberalization in finance subsectors is reflected most in the continued dominance of government-owned entities in the insurance and banking sectors.

Nevertheless the successes of Egypt's economic reform and restructuring program since the early 1990s—sound levels of external debt and debt-service ratios and maturity profile, a substantial services account surplus, reduced fiscal deficits and lowered inflation, and the capable weathering of many external shocks after 1997—put Egypt in a strong position to continue financial sector liberalization.

Egypt has established a strong record of liberalization in the securities markets for domestic and international investors and market participants alike. Liberalization has been accomplished in tandem with a creative and careful development of regulatory capacities and with timely additions of parallel structures for investor protection, clearing, and settlement, and nascent self-regulatory organizations and associations, including the Egyptian Capital Market Association. The value of this sound financial sector infrastructure cannot be overstated, especially if the regional security picture improves and investors gain confidence in the Egyptian market and increase their participation.

The legal and institutional infrastructure developed for capital markets since 1992 is supportive of innovation and provides international firms greater competitive leverage to operate in Egypt. Other WTO members may request commitments that recognize the ability to undertake product innovations and transfer financial information. But capital markets still face significant challenges, particularly in increasing the flow of issues and in widening and deepening the investor base.

To date, banking has been preoccupied with the pace of privatization of state-owned firms and with improving technological infrastructure, such as the payments system and credit information-gathering and assessment capabilities. Participants in the domestic market have provided the major impetus for reform and development, but international firms' contributions through technical assistance, human resource development, investment in information technology applications, and competitive approaches to capital and marketing are widely appreciated. International firms and other countries may seek more flexibility in the form of market access allowed, such as in foreign bank branching.

Egypt has made significant strides in developing a more sophisticated insurance regulatory system and this is reflected in its commitments to the WTO. Fully open to competition for foreign as well as domestic insurance companies, Egypt's regulatory framework should encourage expanded insurance capacity and better technology and insurance products. At the same time, Egypt must develop a plan to educate large segments of its population about the benefits of insurance on savings capacity and personal and commercial risk.

In its current WTO negotiations Egypt will want to develop a negotiating strategy that builds on its regulatory changes in insurance over the past six years because insurance is certain to be a featured sector in services negotiations. To take full advantage of current GATS negotiations, Egypt should take credit for the significant liberalization already accomplished, use negotiations to bolster international recognition for its regulatory advances, continue to use international competition to reinforce its financial market capacities, and inform domestic and international market participants about the advantages of investing in Egyptian financial markets.

Regulatory capacities are being matched with reinvigorated professional management in Egyptian financial firms, but full institutional capacity will not be reached without expanded investments in technology, communications, people, product development, and distribution networks. Attracting highly qualified direct investors who bring both equity and management techniques from leading markets, including anchor investors for restructuring, should be an integral part of Egypt's GATS strategy.

In formulating its GATS requests and in taking advantage of its own liberalization, Egypt should open windows for its own firms in regional markets and reinforce access points that help integrate Egyptian firms into the global network of financial sector participants. In addition, some opportunities for Egyptian firms are not well-recognized, perhaps because of appropriate concentration on pressing demands for domestic restructuring and reform. First, the Egyptian financial market has potential scale and diversification far beyond those of other regional economies. Second, Egyptian financial firms have great opportunities to be leaders in the Mediterranean and Middle East and to serve as informed, professional, and reliable intermediaries beyond the region.

The GATS negotiations in financial services should be used to signal to domestic and international financial markets that Egypt is well-advanced in making its market attractive for domestic and international investment and that it supports business and product innovation. It will be seen as a market of such emerging scale and diversity that international firms with business in the region must participate.

In this report we review Egypt's financial services sector, specifically the capital markets and securities, banking, and insurance, and present recommendations for the country's GATS negotiations. Section 1 discusses global trends in financial services with particular attention to cross-border competition and the productivity that result from advances in information and communication technology. Section 2 presents an overview of financial services in Egypt followed by a discussion of the impact of legal and regulatory changes on Egypt's GATS commitments. Prospects for liberalization and the opportunities for the Egyptian financial sector are presented in Section 4. Section 5 presents recommendations for shaping GATS Negotiations. GATS general obligations, commitments, and annexes are described in the appendix.

1. Global Trends in Financial Services

As intermediaries for savings and investment flows, financial institutions contribute to economic growth, making the financial sector one of the most important sectors in any economy. As providers of payment services and specialized risk management services to other sectors, financial institutions also contribute to funds security and efficiency. Financial service firms are the major providers of market capitalization in many countries and, in countries with established capital markets, supply a significant share of equity and debt issues. Financial firms are each other's clients and counterparts, have subsidiaries or affiliates in one another's fields, train and develop staff who move throughout the sector during the course of a career, and are affected by the pace and effectiveness of reform in each subsector. Productivity and economic growth require investment and technology. Financial service firms are the channel for domestic and international investment and the major demand center for technology applications in developed economies.

This report covers three interdependent subsectors of financial services—capital markets and securities, banking, and insurance. In this section we focus on global trends affecting international and domestic financial markets, individual firms, and regulatory institutions. Those global trends include diversification, specialization, and integration, as well as the rising expectations for financial services performance that these trends generate. Rising expectations also accompany another driver of global trends, the WTO's General Agreement on Trade in Services.

Diversification, Specialization, and Integration

Financial services have been profoundly changed in recent decades by

- Growth in the scale of activities,
- Pressure for international integration of markets, exposure to cross- border and cross-sectoral competition, and benchmarking for capital and performance measurement;
- Magnitude of capital associated with differentiated risks;
- Sensitivity to information and communication capacities;

- Sensitivity to quality of human resource development and staff specialization; and
- Sharp departures from established business models, especially in transition economies with high levels of government ownership and state-directed credit allocations.

Numerous demands are also driving change in international and domestic financial markets, individual firms, and regulatory institutions. Customers, for example, are demanding high-quality and cost-effective services, public policy is demanding that the financial sector contribute to broad economic growth and stability, and investors are demanding returns commensurate with capital dedicated to the sector. These demands reflect global trends, especially

- The spread of information and communication technologies that make it possible for firms to operate in multiple markets efficiently and for clients to compare service choices;
- Global integration of operations by customers and financial firms themselves characterized by expert management techniques with cross-border competence, and
- Recognition of the advantage of diversification for managing business and systemic risks.

The end result is that the general public, investors, domestic policymakers, and multilateral financial institutions have greater expectations of financial markets. And these expectations are remarkably similar across regions and across the public and private sectors. For example, these groups expect that

- Competition is encouraged among all financial market players;
- International firms involved in local financial markets contribute to market and economic growth;
- Banks, insurance companies, and operators in capital markets are prepared for reform and restructuring, including exiting business lines, forming cross-sectoral partnerships, consolidating, privatizing, and making mergers and acquisitions; and
- Financial services regulators and public policymakers reexamine their own missions and approaches.

To meet these rising expectations, developing countries must often undertake macroeconomic reforms, regulatory reforms, and market innovations. Reforms and innovations must be properly designed and sequenced and consistently implemented if the developing country is to benefit. Managing complex financial market reform in developing countries is described in *Managing Risks in Financial Market Development: the Role of Sequencing* (Karacadag, Sundararajan, Elliott 2003). The authors recommend strengthening domestic financial markets by (1) creating the institutional infrastructure to control risks during transition; (2) introducing financial instrument and market innovations according to a logical hierarchy and in a congruent fashion across related activities; (3) sequencing measures; (4) ensuring that financial institutions develop with sound governance, internal controls, and risk management; and (5) establishing domestic market depth and investor diversity before capital account liberalization. Consequently, foreign direct investment should be "selected in a manner that maximizes its contribution to domestic market development."

International finance specialists have focused on how to nurture the growth of strong financial institutions and their regulators in emerging market countries. The nurturing process has often required a careful transition from closed to open market structures and from state-controlled to private ownership and management. The advantages of these changes for societies are found not only in the benefits for individual institutions with capacities for cost and risk management, customer focus, and effective application of new technologies, but also in accessible finance for the public, new bases of financial stability for whole economies, expanded tradable service sectors, and integration into global trade networks.

General Agreement on Trade in Services

Another driver of global trends in financial services is the General Agreement on Trade in Services (GATS). The first legally binding multilateral agreement covering the services sector, the GATS became effective January 1, 1995, following the Uruguay Round of trade negotiations that led to the creation of the World Trade Organization (WTO). The GATS covers measures (i.e., policies, laws, regulations) at all levels of government, as well nongovernmental bodies with authority delegated by their governments. It does not cover services carried out in the exercise of governmental authority, which includes any service supplied neither on a commercial basis, nor in competition with one or more service suppliers.

The GATS defines services in terms of how they are supplied—the modes of supply:

- Mode 1: From the territory of one Member into the territory of any other Member — such as architecture plans submitted electronically between two countries;
- Mode 2: In the territory of one Member to the service consumer of any other Member —such as a person who travels to another country to purchase health care services;
- Mode 3: By a service supplier of one Member, through commercial presence in the territory of any other Member —such as a life insurance company that establishes a subsidiary in a foreign country; and
- Mode 4: Through the presence of natural persons in another member country—such as an engineer who travels to another country and works on the construction of a facility there.

Governments undertake commitments concerning trade in services on the basis of these four modes of supply.

GATS can be broken down into three categories: (1) general obligations that, in most cases, apply to all services, regardless of specific commitments; (2) schedules of specific commitments that include commitments regarding market access and national treatment;

and (3) annexes to the GATS that address sector and horizontal matters. More detail on these categories is provided in the Appendix.

GATS Requests

In formulating a GATS request, countries draw on the experience and perspectives of both their financial market participants and their financial regulators and policymakers. During the past two decades many countries have undergone bank failures, market volatility, restructurings, and recapitalizations and have had to meet the demands of new competitors and product innovation.

GATS requests and offers from leading financial market centers—such as the European Union, the United States, Australia, Canada, Singapore, Hong Kong, and Chile—implicitly recognize that market participants seek to deepen and widen their market opportunities and that financial regulators seek to reinforce domestic financial infrastructure, even as they build supervisory networks with international counterparts.

Many country policymakers encourage the entry of international firms to stimulate domestic markets and improve the competitiveness of financial institutions. WTO members, including small and medium-sized countries and small economies, such as Hong Kong and Chile, have pressed for market opening to expand growth opportunities for their own firms regionally and globally.

During the 1997 Financial Services negotiations, Hong Kong and Singapore played important roles in communicating the technical and market implications of financial liberalization in developing countries. Banks headquartered in Singapore have since expanded their presence in ASEAN countries, and Hong Kong financial firms have participated in the opening of China's market following China's entry into the WTO and the extensive financial services commitments China has made.

Many GATS requests address ***market access*** (e.g., removing equity ceilings, market share restrictions, and economic needs tests; allowing flexibility in form of entry and in cross-border provision of services; adding cross-border data processing and flow of financial information; inclusion of all financial services in the Financial Services Annex) and ***national treatment*** (e.g., binding commitments in all modes; removing restrictions on government procurement and on the nationality of temporary staff and management). These requests make clear that WTO members and market participants alike are seeking to position financial sector competitors in their markets broadly to:

- Design and implement distinct marketing and segmentation strategies;
- Create diversification and specialization of businesses and products in line with the unique vision and competencies of individual firms;
- Respond to increasingly sophisticated and complex customer demands;
- Operate at the highest level of efficiency using all available information technology and communications tools;

- Create value for investors and attract capital supporting institutional and product innovations;
- Improve competence in managing complex organizational change through faster risk measurement and correction of shortcomings; and
- Communicate with the public, regulators, and the market with full disclosure and accountability so that confidence in the financial sector is enhanced.

In summary, market participants and policymakers in many countries are using trade openness to improve financial sector productivity for the overarching purpose of increasing economic growth. This virtuous chain of competitive interaction has parallels in individual firms and in whole economies, and it contributes to global economic growth, human development, and social stability.

2. Financial Services in Egypt

Egypt has a rich history of experimentation with financial sector models since it emerged from colonial domination and achieved national independence in year 1952. From the 19th century when Egyptian financial entities were integrally engaged in the international system of finance, through the nationalization and bureaucratization of the mid-20th century, to the market opening that gained pace during the past 30 years, Egypt has faced all the great challenges of the era. In the Uruguay Round, Egypt demonstrated its liberalization by making the financial sector one of the four services areas in which it scheduled commitments.

The reform and liberalization dynamic introduced by the government in 1991 and generally welcomed by market participants has penetrated all financial sectors. But it has failed to invigorate competition, open new markets, or broaden access to capital on the scale required for accelerating Egypt's growth. The uneven implementation of liberalization in finance subsectors is reflected most in the continued dominance of government-owned entities in the insurance and banking sectors, but it can also be seen in capital markets.

The successes of Egypt's economic reform and restructuring program since the early 1990s—sound levels of external debt and debt-service ratios and maturity profile, a substantial services account surplus, reduced fiscal deficits and lowered inflation, and the capable weathering of many external shocks after 1997—put Egypt in a strong position to continue financial sector liberalization.

Strengthening Change Management Capabilities

The government has articulated forward-looking strategies and policies to increase investment, productivity, and economic growth. Nevertheless, the legacy of state control of the economy has constrained the development of Egypt's financial sector. Consequently, like many East and Central European countries that are trying to meet EU accession requirements, Egypt has had to manage a transition process to limit subsidies directed through banks, reduce government ownership of financial firms, eliminate directed lending, and build capabilities of staff in financial firms.

The financial sector is also especially sensitive to impediments to investment in the wider economy, such as in

- Financial reporting, disclosure, and quality of corporate governance in corporations;
- Fidelity to contracts, predictability of administrative procedures, and reliability of dispute settlement procedures;
- Transparency of governmental economic and fiscal policies and consistency in their implementation over time;
- Human capital readiness in terms of per capita income and educational level; and
- Openness to entrepreneurial innovation and business start-ups.

There is wide international consensus on the need to develop non-bank finance alternatives for capital markets, especially in countries such as Egypt where state-owned banks have provided 50 percent or more of the credit in the system.[1]

Although this report focuses on capital markets, insurance, and banking, non-bank financial services such as contractual savings and pension fund activities may draw more attention in future WTO negotiations. Substantial flows in no contractual savings have not been matched to a significant degree by wider capital market capacities in Egypt (Vittas 1997). Related market opening with the potential for acquisition of specialist skills and financial technologies should not be overlooked.

Institutional Developments

CAPITAL MARKETS

Since introduction of the 1992 Capital Markets Law, securities markets in Egypt have developed, and as of November 2003 1,053 firms were listed on the consolidated Cairo and Alexandria Stock Exchange (CASE). But only about 110 of these firms are traded, and turnover is low (6 percent). The range of market participants has expanded to include brokers, underwriters, rating agencies, investment managers, portfolio managers, primary dealers, venture capital firms, custodians, and financial information providers. Products and services available from providers include equity and government bond issues and some corporate bond activity. International interest in Egyptian issues has been moderate but volatile because of repatriation questions.

The Capital Market Authority (CMA) has emerged as a forceful regulator. It has facilitated a wide range of institutional support for securities activities. Amendments to the Capital Markets Law in 1998 reinforced the CMA's role in regulating insider trading and central depository facilities essential for the dematerialization of securities. The law's delegation of power to the CMA and the CMA's efforts, coordinated with relevant ministries, to adopt regulations keeping up with the pace of change in financial markets have advanced liberalization.

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[1] An insightful analysis of Arab stock market developments focused on the financing practices of firms argues that the pattern of a "bank-based Arab financial system" is likely to persist, even while stock market development is important to balance bank financial services, especially the finance of new industries. (Bolbol and Omran 2003)

The formulation of regulations has benefited from the well-developed, transparent, and consultative practices of the CMA. Public and market participant views are available for consideration before regulatory proposals become. Important institutional underpinnings have been created with the Settlement Guaranty Fund, the Investor Protection Fund Program, and the Misr Clearing and Settlement Depository.

The CMA and market participants have also grown in their capacities to devise common, market-based solutions for conventions and procedures that go beyond direct regulation. Similarly, the CMA, the Central Bank of Egypt, and the Egyptian Insurance Regulatory Authority have shown initiative in setting up cross-sector coordination mechanisms and instituting joint review and approval processes for new activities such as primary dealer arrangements and custodian requirements. Examples of capital market innovations in this period include the GDR of the CIB in 1996, the Eurobond issue by the government in 2001, and the formalization of custodian bank requirements in 2002. Domestic bond issues have been introduced, but the volume remains low.

Two well-recognized challenges confront the CMA and market participants. First, the number of new issuers and trading on existing issues are inadequate. Second, a deeper investor base, especially of institutional investors, will take time to emerge. Since 1992, capital markets have grown strongly, in spite of an overall market downturn through 2002. There were no new issues for more than two years and the number of listed firms declined, although the market improved in 2003.

Egypt has a strong record of liberalization in the securities markets for domestic and international investors and market participants alike. Liberalization has been accomplished in tandem with a creative and careful development of regulatory capacities and with timely additions of parallel structures for investor protection, clearing, and settlement, and nascent self-regulatory organizations and associations, including the Egyptian Capital Market Association. The value of this sound financial sector infrastructure cannot be overstated, especially if the regional security picture improves and investors gain confidence in the Egyptian market and increase their participation.

INSURANCE

Insurance has been offered in Egypt since the middle of the 19th century when foreign companies dominated the market. In the early 20th century, Egyptian companies, in some cases joint ventures with foreign companies, appeared. An Egyptianization process began in 1957 and led to the nationalization of the insurance industry into four companies in 1964—three underwriting companies and one reinsurance company. Act no. 43 in 1975 allowed foreign insurance companies to offer insurance in Egypt strictly in free trade zones. Egypt provided significantly new opportunities to foreign insurers in 1995 (Act no. 91/1995) when it permitted foreign companies to operate outside the zones through minority (49 percent maximum share) joint ventures with Egyptian companies. Foreign equity ceilings were lifted in 1998 (Act no. 156/1998) along with other measures that provided significant, new opportunities for insurance providers.

The 1995 and 1998 measures also eliminated an economic needs tests as a condition for an insurance license, removed price ceilings on insurance premiums, reduced the percentage of mandatory cessions significantly, permitted cross-border transportation insurance, lifted restrictions on new products, and used a file-and-use system of product approval to expedite the introduction of new products. Finally, the government has announced that it intends to privatize the four state insurance companies. Although the date for the privatization has not been set, initial steps, including valuation assessments, have been undertaken.

The Egyptian Insurance Supervisory Authority (EISA) has overseen these changes in addition to a number of reforms of a prudential nature, such as increasing solvency margins, establishing a manual for financial examination procedures, and adopting international accounting standards for insurance firms. These are significant undertakings by any standard, and most have occurred in the past five years. The challenge is to assess their impact on the growth and development of the Egyptian insurance market in light of how recently they have entered into force. What is clear, however, is that Egypt has established a more predictable regulatory environment in which insurance can be offered, and the steps it has taken to liberalize and privatize the insurance market make it possible for larger elements of Egyptian society to have insurance.

The insurance industry in Egypt continues to be dominated by the four state-owned companies, which take in more than 72 percent of premium income, as well as a reinsurance company. Today, there are 16 private insurance companies, four of which are foreign-owned. Recent liberalization measures have enabled foreign insurance companies to assume a larger role in insurance underwriting in the country, although their share is still a fraction of the market. Egypt remains an underinsured country with insurance premiums comprising 0.4 percent of GDP (compared to 8 percent in the United States and 15 percent in the European Union). And it is behind countries such as Morocco (2.9 percent), Tunisia (1.8 percent), Mauritius (4.3 percent), Kenya (3.9 percent), and Lebanon (3.9 percent), particularly in the non-life business.

Egypt still needs to increase exposure to insurance for more of its population, which is particularly challenging for lower-income segments that do not have the means to develop savings and protect against risk. Nonetheless, Egypt has a growing middle- and upper-income population that is likely to stimulate the growth of the insurance market.

The EISA is a dynamic regulator that has introduced measures that have encouraged competition and innovation in the insurance sector. Its system of regulation is transparent according to an assessment conducted by the International Association of Insurance Supervisors (IAIS) in 2000 of EISA's Core Principles and Transparency in Insurance Regulation. Regulations and other measures are made available to the public through an official gazette. It maintains a system of consultation with professional associations and other public institutions when considering changes to regulation or the introduction of new policies. The significant statutory and regulatory changes outlined above have helped create the right climate for making the industry more competitive and meeting customers' needs. This is underscored by its encouragement of new products through the file-and-use system, and a general willingness to allow insurance companies to set the price of insurance products. According to interviews with representatives from state-owned and private companies, the presence of foreign insurance suppliers has stimulated product innovation. Thus, although Egypt's insurance market remains underdeveloped, its regulatory philosophy in the past 10 years has created an environment that encourages the privatization of state companies, new entrants, full price competition, reduction of mandatory cessions in reinsurance, and new and innovative insurance products.

BANKING

Liberalization of the banking sector started with the passage of the Investment Law in 1974, which initiated the reversal of nationalization for domestic banks. It allowed international banks to participate in joint ventures (up to 49 percent equity) and open branches that, however, were restricted to taking foreign currency deposits. Nearly 20 years later, 1992–1993, amendments to the banking law extended national treatment to international banks and allowed established foreign bank branches to take local currency deposits.

Today, the central bank supervises 55 banks, including 3 specialized banks and 52 essentially commercial banks, headed by the 4 state-owned public banks (representing the majority of bank market share measures). There are 13 foreign bank branches. The remainder includes both private and public banks established under the Investment Law. Of these, 11 are joint venture banks, which include public ownership (most up to 20 percent, with cross-shareholding from public banks and other official bodies, and many with international bank equity as well).

In 1996, the Banking Law No. 97 permitted international partners to have majority ownership of joint ventures. Reductions in state shareholdings in joint venture banks and privatization of public sector commercial banks followed the 1998 change allowing privatization. During the subsequent five-year period, authorities encouraged new investment in joint venture banks while discouraging the establishment of domestic banks or new foreign bank branches.

This stance is consistent with the view that the restructuring of private and public financial firms must reach a level that supports consolidation and that the internal reform and modernization of individual banks must be completed. In the meantime, the government has reduced its shareholding in joint venture banks, increased the capital of public sector banks, and through the laws No. 37 issued in year 1992 and No. 88 issued in year 2003, has required commercial banks to raise capital levels. Moreover, the leadership and operating policies of the public sector banks have been privatized in the limited but important sense that they operate on commercial principles. The market shares of private and public banks are now roughly 50/50, a positive sign for competitiveness of the banking sector. The banking system has reduced lending to public entities while increasing lending to private borrowers (and household borrowing has remained flat).

The Central Bank's July 2003 update of its reform policy for the banking sector provides an excellent summary of the wide range of integrated steps underway to strengthen the financial services sector and its institutions. The Central Bank supervisor lists the following priorities:

- Reinforce the information infrastructure for creditworthiness and other decision making by banks;
- Modernize the payment system, including the introduction of real-time gross settlement;
- Strengthen the corporate governance and internal rating systems of banks; and
- Privatize joint-venture banks.

In the past year, prudential regulations were documented and made easily accessible; minimum capital adequacy requirements were raised to Basle II standards; classified loans were monitored; certain banks were disciplined through management changes and overriding dividend distributions; and the Cairo clearinghouse was automated.

These activities arose from initiatives from 2001–2002 that were consistent with the Central Bank's development plan for its own operations, including

- Comprehensive assessments of banks' capital adequacy, asset quality, management, liquidity, profitability, and risk controls in conjunction with on-site inspections
- Extensive training in concert with the Bank Institute, reaching more than 4,000 trainees and managers[2]
- Increase in the capital adequacy requirement from 8 percent to 10 percent;
- Regulations and implementation rules for e-banking and e-money, consumer protection for retail services, mortgage banking, primary dealers, and anti–money laundering; and
- Support to the electronic clearinghouse and computerization of brokerage, treasury bills, and government bond transactions.

These actions are essential for Egyptian banks to attain returns on assets and equity in line with international standards. With such performance, Egyptian banks can also achieve scale of operations and investment in technology, people, and distribution networks commensurate with the needs of the economy.

Through its network of professional connections with their international counterparts the Egyptian banking sector and regulators have been able to foster staff training and development, welcome the return of Egyptian banking specialists with international experience, and absorb technical assistance and technologies critical for competitive banking. This openness and strengthening of banking expertise according to global best

[2] To serve the ambitions of some market participants to expand Egypt's export potential in financial services, the Central Bank and others are contributing to Cairo's regional financial center by conducting extensive training programs for counterparts from the region.

practices is paying off in multiple ways; for example, in the adoption of SWIFT for interbank payments, in the development of a national switch for ATM interoperability in Egypt, and in the development of on-line credit reporting.

As noted in the discussion on capital markets, the banking sector relies on close cross-sectoral collaboration among firms and coordination among regulators. In 2002 the IMF and the World Bank prepared an assessment for Egypt in line with the global standards employed in the Financial Sector Assessment Program (FSAP) since 1999, and according to the Central Bank's 2001–2002 annual report, applauded the steps taken to enhance the soundness of the financial sector.

The widely reported slowdown in wider economic reforms appears to have affected the pace of change in the financial services sector, especially in state-owned firms. Nonetheless, the positive legal, regulatory, infrastructure and institutional changes during the past decade have created a platform for innovation by market players.

Impact of International Firms

Interviews with regulators and participants in insurance, banking, and capital markets revealed a positive view of the impact of international firms in the domestic market. Some expressed disappointment with the pace and extent of liberalization and minimized the potential of international firms to make a major difference in the process. Most accepted the conventional view that new licensing or new entrants need to be limited until restructuring in the banking and insurance sectors is complete. No examples of international firms disrupting domestic markets or contributing to unstable conditions were offered, however. Several firms expressed regional
, including following corporate customers with expanded businesses abroad; attracting foreign clients who have corporate and personal banking needs in Egypt, and leveraging new capabilities in investment banking and investment management. Others gave little weight to Egypt's export potential in financial services in the near term.

Several interviewees expressed surprise that international firms had introduced little in the way of product innovation, improvement in service quality, initial public offerings, or nontraditional distribution networks, although others pointed to innovations in retail banking, credit cards, and capital markets.

Many see that most financial market development in Egypt comes from reinvigorated domestic firms, especially those with new professional management. The recent initiative by regulators and policymakers to solicit the insight and counsel of leaders was applauded, and it was suggested that this practice be extended systematically to the full circle of financial market participants and firms' technical specialists .Many were mindful of the time needed for strengthening individual firms, but they simultaneously conveyed a sense of urgency about Egypt's seizing an historic opportunity to extend the reform process. Interviewees spoke about privatization of state-owned banks, the impacts of government shareholding in the sector, and the need for wider consolidation, among banks in particular. However, these comments revealed the need for a process to create an informed and analytical review of alternative future paths for financial markets in Egypt, followed by a rearticulation of strategy and policy encompassing private and public sector commitments.

Most of the managers interviewed cited significant advantages to having international firms in the Egyptian market, such as

- New competition enabling broader change, such as stimulating a stronger bank credit culture;
- Technical assistance at many levels, from partnerships with domestic counterparts to cooperation with regulators on introduction of new utilities and regulations[3];
- Human resource development including training for new hires as well as current staff;
- Investment in technology and development of skills in managing technological applications and cost-reduction strategies;
- Product and credit pricing disciplines tied to economic cost and capital allocations leading to realistic competitive behavior;
- Introduction of new client and business line techniques such as market segmentation, profit center analysis, and client management skills;
- Introduction of credit cards;
- Stimulation of public awareness of financial choices and opportunities;
- Reinforcement of official regulatory initiatives to strengthen accounting, audit, disclosure, financial reporting, corporate governance, and the responsibility of corporate board members; and
- Advancement of new services and sector infrastructure such as securitization, funds management accountability, primary dealer and bank custodian functions, and settlement system innovations.

Regulators and market participants operate with a balanced and confident grasp of the strengths and weaknesses of international firms in an emerging market environment. From our discussions with them they appear to be forward-looking managers who value liberalization. They expressed the need to invest in the next generation of financial sector specialists and leaders, and indicated a readiness to continue or accelerate the pace of change.

During the interviews we heard mostly cautious expressions of a vision for expansion in the financial market in Egypt and potential growth, perhaps because many focus so tightly on immediate priorities. Implicit and expressed views in many cases were that the market

[3] Interviewees consistently recognized the contribution of international assistance programs in the sector (from the European Union, the United States, and international financial institutions) as well as the cooperative benchmarking of regulatory organizations such as IOSCO and the Basle Committee on Banking Supervision.

has too many banks, that insurance services are reaching the available market, and that the weak flow of new securities issues is understandable.

Is additional market research needed to assess the needs of users of financial services and the potential scale of market segments consistent with wider economic and social development goals? Potential areas to probe include the following:

- Retail and consumer banking gaps in terms of small depositors and borrowers and geographic regions, and an assessment of the impact of deposit insurance on competition for this market segment.
- Impact of additional financial sector privatizations on supply and demand for securities products.
- Number of privately owned firms with potential for public listing and growth opportunities assuming non-bank financing.
- Impact of antitrust and state-aids disciplines on supply-of-securities issues and their impact on bank asset portfolios.
- Impact of a credit reporting system on market scale and returns for banks.
- Impact of government using e-banking and e-government (direct payroll credits, pension, social security, and tax payments).
- Problems of business start-ups in accessing capital and credit and means to advance creditworthiness practices by small and medium-sized corporations.
- Alternatives for and impacts of expanding range of pension fund asset choices and management.
- Impact of allowing creation of independent distribution networks for mutual funds.
- Assessment of how the EU accession process in the financial sector motivated Eastern and Central European financial sectors to accelerate reform and widen their vision of the scope of their own market.[4]

Using GATS commitments in the banking sector to encourage the spread of financial technologies has great potential. In developed-country markets—retail and wholesale banking and front office (client interface) and back office (handling large data volumes cost-effectively) functions—skillful management of technology has proven critical. Financial technologies can be introduced through multiple channels, including regulatory mandate and supplier marketing, but just the presence of early-adopters and firms with proven expertise, including international banks, can help spread needed financial technologies. Analysis of the U.S. market revealed that technologies spread rapidly through counterpart firms such as payment-service providers and through information

[4] In the financial sector, the EU accession process requires candidate countries such as Poland to align their laws with the EU legal framework. For example, Poland included bank branching in its 1997 GATS commitment, and candidate governments have had to eliminate subsidies affecting finance. The subsequent market opening has attracted direct investment not only from neighbors such as Austria but also from new financial market centers such as Ireland.

exchange for credit reporting. Egypt is adopting new technologies in these areas (Berger 2003).

GATS commitments can be viewed in terms of their potential for stimulating investment and competition in underserved market segments. For example, a forthcoming analysis of international comparisons of community banking finds that foreign banks in some developing market economies have played an effective role in reaching small and medium-sized enterprises. Although it is often assumed that foreign banks face disadvantages in terms of client information, some banks overcome them through organizational skills and technology applications (Berger *et al*. 2004).

Liberalization of the insurance market in Egypt is perhaps too recent to assess the impact of foreign insurance companies. Only a few years ago, foreign insurance companies could do business only in free trade zones. When companies were allowed to underwrite insurance outside the zones in 1995, they were required to do so through a minority joint venture. These restrictions were eliminated in 1998. The impact of liberalization may have been reduced by difficult economic times, and the market is only beginning to emerge with real growth opportunities. Foreign companies therefore have only recently entered the market and have started operations in a typically conservative way by seeking selective underwriting.

In the short term, insurance capacity will be limited until the insurance industry is fully privatized and more capital from state-owned companies (which occupy more than 70 percent of the market) is generated. In our discussions with representatives of foreign and publicly owned companies, we observed enthusiasm for the regulatory changes that have taken place, in particular the incentive to offer new and different products to address certain risk circumstances. The presence of foreign insurers, together with an encouraging regulatory climate, is therefore seen as a positive factor in the development of Egypt's insurance market, whether because of the new products and technology these companies bring, or because of the potential for greater insurance coverage in the country. Egypt liberalized its insurance market according to its own timetable rather than in response to the demands of trade negotiations in the WTO. But its commitments in insurance not only provide the predictability foreign insurance companies desire, but they also signal to the world the changes the country has made in providing opportunities for foreign insurers. In a sector such as insurance, the impact of these changes—regulatory reform and WTO obligations—takes time to be felt, so it will be interesting to see how foreign insurance companies take advantage of opportunities as Egypt emerges from economically stagnant times.

There is no plan to address the issue of the uninsured or the underinsured in Egypt. Government and industry must undertake greater efforts to educate Egyptians about the value of insurance for personal and business reasons. In the final analysis, the ability to reach people at all income levels will depend on the affordability of insurance and, where appropriate, increasing areas where insurance is mandatory. But until a larger capital base exists from which participants can operate, it will be difficult to expand insurance coverage in Egypt—one reason privatization of state-owned firms should be undertaken as soon as possible.

3. Impact of Legal and Regulatory Changes on GATS Commitments

Advantages of Capital Markets Model

The Capital Markets Law and the spirit in which it has been implemented by the CMA and the government have established a strongly positive model for other countries that have yet to schedule and bind liberalization to the same extent. Not only will Egypt be the target of a few GATS requests for this sector, it will also be in a position to leverage its openness to seek comparable treatment from partners in other sectors important for Egypt's access goals.

Egypt's established model for capital markets is unlikely to result in national treatment issues for international participants in its market as current and new legal and regulatory changes are introduced. In addition, the CMA's procedure for soliciting market participant comment on new rule-making also minimizes the potential for major differences.

Some WTO members with developed capital markets may seek new commitments in the following unscheduled areas that do not appear to be contrary to existing law:

- Listing and binding of transfer of financial information (covering, for example, securities market research data and reports);
- Listing and binding "services auxiliary to financial services"; and
- Pension fund management services (Egypt has scheduled portfolio and investment management under Other Financial Services/Securities without reference to pension fund management).

Regardless of how Egypt may respond to such questions, its existing GATS schedule undoubtedly will meet or exceed the expectations of most trading partners.

Insurance-Leveraging Regulatory Changes

Egypt's regulatory actions since the last round of financial services negotiations in 1997 reflect, in several instances, a more liberal regime than its schedule of WTO commitments suggests. In preparing for negotiations, Egypt will want to develop a strategy that takes credit for these actions, as well as its liberal general regulatory environment for insurance, as it entertains additional requests from other countries. This assumes, of course, that Egypt is prepared to bind these changes in its schedule at the conclusion of current negotiations. A reading of Egypt's current schedule of commitments, in comparison with its current regime, reveals further liberalization undertaken autonomously in the following areas:

- ***Full elimination of economic needs tests as a basis for considering a foreign license application.*** Egypt's schedule states that needs tests would be "relaxed" by 2000 for life, health, and personal accident, and for non-life companies by 2002. Full elimination is a more definitive and predictable action, and provides a basis for credit.
- ***Full elimination of limitations on foreign equity that a foreign insurance company can hold in an Egyptian insurance company.*** Egypt's current schedule allows for a maximum foreign equity of 51 percent by 2000 in the case of life, and the same maximum percentage in non-life by 2003. By removing equity caps, Egypt has exceeded its GATS obligations in an area of considerable importance to foreign insurance suppliers, which generally seek maximum flexibility in the amount of equity they can hold in their overseas joint venture or subsidiary.
- ***Mandatory cessions in reinsurance****.* Egypt has reduced to 10 percent the mandatory cessions that insurance underwriters must give to the Egyptian Reinsurance Corporation (Egypt Re). Egypt's schedule leaves it to the discretion of the EISA to determine the mandatory cession percentages, which left open the question of the level of mandatory cessions that insurance underwriters must respect. Thus, Egypt has reduced mandatory cessions substantially, compared to levels at the conclusion of the last round of financial services negotiations in 1997. Given the importance of this issue to some countries, Egypt is well-positioned to take credit for its actions if it binds the current 10 percent maximum cession to Egypt Re. (The additional 5 percent mandatory cession to African Re, which is reserved in Egypt's schedule, remains in place.)

NEGOTIATING CREDITS FOR AUTONOMOUS LIBERALIZATION

GATS Article XIX.3 calls for the establishment of guidelines for the treatment of liberalization taken autonomously between negotiating rounds. While the concept is included in the guidelines for the current negotiations, no agreement has been reached on the content of guidelines affecting autonomous liberalization. Nonetheless, member countries have agreed to the principle of allowing a credit, despite the fact that they have not been able to agree on how to quantify or treat the credit. On the basis of country submissions and secretariat analysis, there is little disagreement that the credit cannot be recognized unless the party is prepared to bind the measure at the conclusion of the negotiations. A country may wish to provide draft language in its offer that would express precisely how the liberalization granted autonomously would appear in its final schedule. The credit could be used as a defense against requests for further liberalization, probably in the same sector, or it could be used offensively, in seeking specific commitments in areas of interest to that party.

Many delegations have emphasized assessing the quality of the measure for which a credit is sought and that the party claiming the credit should demonstrate its value in providing greater market-opening opportunities for foreign services or services providers. Developing objective criteria or other means to establish a formula that quantifies the value of such a measure seems elusive because of statistical inadequacies in the services sectors. At the same time, countries generally are prepared to calibrate their requests (and possibly offers) when the country claiming credit can demonstrate the significance of the measure in terms of its effective market access. In the final analysis, a country's ability to gain the serious attention it believes it deserves for an autonomous measure may rest with its ability to threaten to take items of potential interest to other parties off the table until the credit it is seeking is given the respect it deserves.

With these undefined guidelines, Egypt can make a very strong case that the measures it has taken outside its schedules of commitments are significant and provide greater market opportunities in the insurance sector. Each of the four areas described previously adds considerable value to the case for a negotiating credit for autonomous liberalization. At the same time, unlike the other three measures, a credit should not be oversold for the full elimination (rather than the relaxing) of economic needs tests. Inevitably, other parties will view some measures as more significant than others, and Egypt should try to see the viewpoint of the other side as it considers how to negotiate a credit. In any event, these autonomous measures should have strategic weight against requests of Egypt in the insurance sector described next.

LIKELY REQUESTS OF EGYPT

In reviewing the requests to which we have had access, we believe Egypt will be pressed to improve its commitments in the following areas:

- ***Branching.*** This may emerge as the highest priority for some countries in the insurance sector because many insurance providers prefer this form of commercial presence. Egypt currently permits commercial presence through subsidiaries or joint ventures. Branching may not be viewed as an acceptable form of commercial presence by Egyptian authorities, who are concerned about ceding a large part of regulatory supervision of the branch to the home country. At the same time, the value of a branch structure is the capacity of the foreign insurance company to leverage its risks against a larger international risk pool, thus enabling the company branch to provide greater insurance coverage in Egypt than it could as a subsidiary. Egypt has plenty of negotiating tools at its disposal, especially in light of having autonomously removed foreign equity ceilings. It must weigh these considerations against its long-term goal of expanding insurance coverage in the country and the possible role foreign companies can play in this process.
- ***Mandatory cessions.*** Mandatory cessions are viewed as raising the cost of a risk and thus the cost of an insurance policy. A mandatory cession permits the initial reinsurer—in this case, Egyptian Re—to receive the highest fee in the process of bearing the principal cession and retroceding the risk to other reinsurance companies. Underwriters resist mandatory cessions because the highest fee is paid in the absence

of competition. Egypt therefore may be asked to remove mandatory cessions, either to The Egyptian Reinsurance Company or to the African Reinsurance Company. But the issue may have a lower priority in light of the significant reductions in mandatory risks Egypt has undertaken recently.

- ***Auxiliary services.*** Egypt may be asked to improve its commitments in this category in the following areas: (1) binding modes 1 and 3 in intermediation (brokerage); and (2) adding a commitment to mode 1 in actuarial and loss settlement services. Of these categories, intermediation may receive the greatest attention because a foreign broker has no basis to supply its services in Egypt. Brokers should help deliver the best insurance product at the best price as they shop among underwriters who insure risks that clients present. Foreign competition in brokerage has considerable value in providing a larger pool of human capital necessary to facilitate the best insurance options to cover risks.
- ***Additional commitments.*** It is likely that Egypt, along with most other countries, will be asked to bind certain regulatory practices that are nondiscriminatory nature, which is why they would be listed in the "additional commitments" column of the schedule. These practices include transparency provisions, some of which are incorporated in the request of the United States. Countries may also request that Egypt bind its current practice of approving insurance products on a "file-and-use" basis.

Egypt enters the Doha Agenda in a good negotiating position for the insurance sector. Its changes in regulation and supervision in the past decade have improved the climate for foreign insurance suppliers dramatically. It has taken measures autonomously, that, along with its overall regulatory climate, can be used to its negotiating advantage. At the same time, Egypt should consider whether certain changes, however defensible at the negotiating table, might extend the reach of insurance underwriting when the country remains comparatively underinsured. Some of these changes need not be bound in the GATS. They can be adopted not as international obligations, but as obligations for which Egypt would like to maintain flexibility as it assesses the long-term value of these changes.

Policy Constraints on Banking Model

The Banking Law, including the measures enacted in July 2003, provides a solid foundation for the liberalization already reflected in Egypt's schedule of commitments for banking, especially for the full listing of sector/subsector services. In addition, Egypt's binding of mode 4 (presence of natural persons) for both market access and national treatment should be credited.

Egypt may receive requests from developed-country trading partners to list the following banking services from the Annex on Financial Services, which may or may not be allowed by law or which Egypt may view as belonging under Other Financial Services instead of the banking sector:

- Mortgages
- Factoring

- Derivative products, exchange rate or interest rate instruments
- Corporate advisory and services auxiliary to financial services
- Transfer of branch or subsidiary operational data

To the extent that some of these services, such as derivatives, are not covered by current law, Egypt has alternatives—simply to refer to its national treatment policy for the sector, or at the appropriate time, to make a commitment effective with passage of the relevant legislation.

With regard to mortgages, Egypt has not yet implemented a law, and it may be timely to include mortgages in the new schedule.

Egypt may also receive requests to consider removing its unbound listings for modes 1 and 2 (cross-border supply and consumption abroad) for market access and national treatment as it has done for securities. The recent electronic signatures law and the Central Bank's policy of issuing special licenses for e-banking are good measures in anticipation of cross-border supply in particular.

Wider policy constraints reflected in the banking law and the administration of market access by the Central Bank appear to be most important with respect to mode 3 (commercial presence) limitations in Egypt's schedule. There is no question that international banks already operating in Egypt as joint venture banks or branches of their head office enjoy national treatment.

This question of the form of choice to establish in Egypt remains for any international bank considering new entry because access is effectively limited to purchasing a position in an existing joint venture bank. The law does not allow establishment of a *de novo* subsidiary.

Establishment of a branch is allowed by law but in practice the Central Bank discourages new branch licenses. Branch applications are also subject to an economic needs test reflecting the desire for wide prudential discretion. The limitation on national treatment of branches of international banks also appears to limit local currency dealing to branches existing on June 5, 1992. Assuming branch licensing is welcomed by the authorities in the future, potential new entrants are likely to see this limitation as a strong disincentive. Finally, it is not clear why the national treatment limitation for joint venture banks requires "on the job training for national employees." It is impossible to imagine such an entity operating without a strong commitment to human resource development.

If the government and the Central Bank proceed in their restructuring, consolidation, and privatization of the banking sector, international banks can be instrumental in their success, not only through joint venture banks, but also through wider direct investment in the sector. The current profile of the schedule may not be seen as optimal by strong international firms that seek flexibility in entering new markets. Although working with an established local partner has recognized advantages, some firms will be ready to assume the responsibility of either putting together their own local investor group or operating through a direct branch. In either case, such new entrants not only inject new capital into the financial sector but also invest in technology, people, and extensive management systems.

If Egypt waits until current negotiations end to signal its future flexibility on its bindings and form-of-entry limitations, it may miss an opportunity to stimulate fresh thinking about participation in Egypt's banking sector by first-class institutions with the potential to bring significant investment and competition to this market.

4. Prospects for Liberalization

Perspectives on Egypt's Opportunities

Egyptian financial sector policymakers have an opportunity to couple future domestic liberalization initiatives with the injection of international competition in the economy. In each subsector, changes in law, regulation, or policy orientation can encourage international firms to apply greater capital, talent, and specialized management disciplines to meeting the challenges of domestic market liberalization in Egypt. Although the accomplishments of the past decade are significant, the need is compelling to bring the entire sector to the next level more quickly. This task will be made easier by Egypt's successful record of international portfolio investors and international firms that have invested directly in the domestic securities, insurance, and banking industries.

The following list gives an indication of how the anticipated impact of domestic market changes could be magnified through greater participation of international firms in the liberalization process. Many of these points echo the comments of the firms interviewed during the preparation of this report.

- Capital markets
  - Draw on international experience with securitization to accelerate implementation of the mortgage law
  - Contribute to liquidity and market convention definitions supporting the expansion of the primary and secondary markets for government and corporate bonds
  - Introduce experience from other markets in pension fund management
  - Reinforce the disciplines already introduced in Egypt for use of International Accounting Standards and corporate governance standards as a consequence of the vigilance of international analysts and portfolio investors
  - Support the introduction of capital market tools and products for market liquidity and risk management, including short-selling and derivatives in due course
  - Participate in the privatization of state-controlled entities

- Banking and insurance
  - Expand outreach to potential and underserved retail customers and new investor classes of financial services by introducing market segmentation, product innovations, relationship management techniques, client and risk management technologies, and financial education initiatives aimed at market expansion
  - Contribute to improvements in the bank payment system
  - Restructure corporate advisory expertise including due diligence and valuation
  - Finish privatizing state-owned insurance companies
- All financial services
  - Deepen distribution alternatives for all market participants, including risk-sharing techniques and pressure for creation of new networks
  - Create demand for outsourcing of financial service specializations and for private-labeling of financial products for use by industry partner clients
  - Integrate Egyptian finance into global networks for product development and operational support in fields such as financial analysis and business software development.

Realizing the potential of greater international participation does not need to wait for resolution of regional security concerns; it can be done in parallel with macroeconomic policy and completion of the internal reform programs of existing state-controlled financial entities. WTO negotiations allow Egyptian policymakers to use the scheduling of commitments as a powerful signaling device to domestic and international market participants. Signals with scheduled dates of changes in market access for banks and insurance firms, for example, could accelerate internal reform and privatization. This approach assumes an aggressive rather than a defensive posture in the negotiations aimed both at attracting high-quality foreign direct investment to the financial sector and at anticipating the needs of Egyptian firms for new markets, especially in the region, beyond what the firms may have articulated.

International Comparisons

BANKING

In the 1997 Financial Services Negotiations—and then with an eye on new negotiations—countries have tailored GATS commitments according to the degree of their macroeconomic stability, the robustness of their prudential regulation, experience with foreign firms, and overall orientation to liberalization (Harms *et al*. 2003). Researchers have stressed the significance of understanding services trade as foreign direct investment because a local presence is important to the provision of services, especially for most financial services. The range of variables in the GATS financial services schedules is wide, and fine-grained comparisons are difficult because of the latitude for scheduling sectors and services, bound or unbound, and horizontal provisions. However, independent assessments of the 1997 Financial Services negotiations generally can show that most countries scheduled liberalization below current practice and in a few cases phased in additions over several years. With this background in mind, we selected some countries for some comparison according to their regional proximity, economic scale, or financial market development and ambition.

Turkey

In its response to the WTO's Trade Policy Review in November 2003, Turkey reconfirmed its strong commitment to liberalization of services, and financial services in particular, especially in the context of the EU accession process. The financial sector liberalization process began in earnest nearly a decade earlier than in Egypt, but Turkey has also experienced more severe volatility and failure of firms in the sector. While the restructuring of banks continues in the context of the government's financial market strategy, capital markets have reached higher levels of activity than in Egypt, including market liquidity attributes such as short selling and margin trading not yet introduced in Egypt. Out of roughly 75 banks in Turkey, 18 have included foreign bank subsidiaries, 12 of which have been through branch presence. In its public communications on banking and the stock exchange, the government writes, "Despite their small market share, foreign banks have an important place in the Turkish banking system because of the new concepts and practices they have introduced."

A recent analysis of liberalization, ownership, and productivity in Turkish banking found that liberalization since the 1980s has been associated with productivity improvements for all banks—established and *de novo*, public, private and foreign—although there are distinctions according to longevity, scale, and technical prowess. In spite of no restrictions on nationwide expansion, few new banks opened in locations outside major cities (Isik *et al.*).

Korea

Like Turkey, Korea faced severe financial market volatility and disruptions near the end of the GATS Financial Services negotiations in the late 1990s, partly as a result of "ill-prepared liberalization of financial services lacking sound financial infrastructure and strong supervisory systems" (Korea 2001). Also like Turkey, Korea did not draw back from financial liberalization, but widened commercial presence in areas such as securities. Given its experience, Korea urged steps to strengthen financial services as preparation for future liberalization and cautioned that commercial presence barriers be "gradually abolished by all members." Contentious political debates have continued to simmer about foreign equity control.

Malaysia

Malaysia's bank lending openness appeared close to Egypt's but lagged Egypt's in formal openness to deposit-taking and securities activities. In its March 2003 submission to the WTO on financial services, Malaysia outlined the extent of foreign penetration in its banking, insurance, and securities markets, including actual equity ownership levels and market shares above Egypt's levels. Nonetheless, Malaysia makes it clear that it has strong reservations about further market opening until local institutions have the time to close the skills gap in fields such as credit and risk management. In addition, the country ascribes a high priority to completing the restructuring, consolidation, and merger process underway in the sector. Finally, Malaysia desired full flexibility in exercising capital account controls in the wake of the Asian financial crisis, and this perspective undoubtedly affects its attitude toward the extent of foreign presence in the sector. This constraint is reflected in both the retention of economic needs tests and market share limits in Malaysia's schedule.

South Africa

South Africa's GATS commitments in banking and securities were inclusive of branches and subsidiaries for commercial establishment. Horizontal commitments specify that subsidiaries must be in the form of a joint stock company, and that local borrowing by entities with more than 25 percent ownership is limited. The list of services is extensive and includes derivatives, auxiliary financial services, and a broad definition of asset management including pension fund management. Transfer of financial information and data for processing is bound. Nationality restrictions are specified for stock exchange membership. Modes 1 and 2 are generally not bound. While South Africa continues to face challenges in extending banking services to the lower-income markets, the country's capital market are well-developed. A number of South Africa's major banks are seen as internationally competitive, and they are active in finance throughout the region.

INSURANCE

As indicated earlier, compared to other countries in the region, Egypt is clearly underinsured. We selected several developing countries from different regions, some of which have different growth, per capita income, and overall GDP. Nevertheless, they represent a cross-section of developing countries with specific experiences in insurance trade liberalization and associated WTO commitments. We briefly examine their situations to assess the relationship of insurance growth and density in these countries, in comparison to their trade obligations.

Chile

Chile has a population of 15.7 million and ranks among the more advanced countries in the Southern hemisphere with a per capita income of more than $10,000. No Latin American country has liberalized its capital markets more during the past 20 years. A significant influx of foreign investment followed its liberalization of capital markets in 1985, and this has contributed to considerable growth in the economy with a resulting increase in per capita income and a greater appetite and capacity for personal and business insurance. Insurance was opened to foreign competition in 1985 as part of overall economic and financial reforms. Foreign companies are permitted to establish as subsidiaries and there is provision for cross-border reinsurance and brokerage. Foreign insurance companies account for 70 percent of underwriting in Chile. There are 58 insurance companies in Chile. Insurance premiums account for 4.3 percent of GDP.

Despite the fact that it opened its market to foreign insurance companies years before Chile did not undertake commitments for financial services until the negotiations in 1997, Chile, therefore, is an example of a country that liberalized its market before WTO negotiations and did not register commitments in insurance until after the Uruguay Round. Its commitments are thus an outgrowth of broader financial reforms that were undertaken years before WTO negotiations. The great value to the commitments of Chile is their predictability backed by the international legal obligations is has taken in the WTO.

Morocco

Morocco has insurance commitments somewhat similar to those of Egypt: establishment through subsidiaries or joint ventures, and 10 percent mandatory cessions to its government-owned reinsurance company. Morocco's regulatory regime, as judged by the International Association of Insurance Supervisors, does not receive the level of positive ratings as does the EISA. Nevertheless, its overall premium volume is twice that of Egypt's (2002) with a population that is roughly half the size (29.3 million) and a per capita income of $1,030. Its insurance premiums as a percentage of GDP are 3 percent. Of the 18 insurance companies in the country, two-thirds of insurance is underwritten by two financial conglomerates that dominate the banking and insurance sectors. With four foreign insurance companies, the role of international insurers is very small. In 1997 Morocco bound in the WTO a recently liberalized insurance regime that two years before imposed minority joint venture requirements on foreign companies. In its recent Trade Policy Review, Morocco reiterated the importance of liberalization of financial services, including insurance. The country is not desperately uninsured but neither does it benefit from competitive rates and products, despite the absence of regulatory restrictions. Its problems are more structural in nature (the government owns only the reinsurance company), and its recent liberalization of insurance to foreign companies, backed by WTO commitments, has not taken hold. Thus Morocco is representative of a country with good WTO commitments reflecting a relatively positive environment for foreign insurers but with little in the way of foreign insurance activity.

South Africa

South Africa is the largest insurance market in Africa, largely because most savings are devoted to life insurance products. It is a medium-sized developing country with per capita income of $10,000, and 50 percent of 42 million people living below the poverty line. There are more than 300 insurance companies in the country, 144 of which are foreign. South Africa permits foreign entry into its underwriting market in the form of subsidiaries, and joint venture acquisitions must be approved by regulatory authorities. Despite the large number of insurance companies, 50 percent of property casualty insurance is provided by two indigenous firms. A greater spread exists among life insurance companies, many of which offer pensions and savings included in life insurance policies. Its insurance premiums were 18.78 percent of GDP in 2002, the largest of any country. The life insurance premium/GDP ratio alone was 15 percent.

South Africa's current liberal regime in insurance and other financial services commenced with profound political changes in 1994. This openness coincided with the 1997 WTO financial services negotiations, when South Africa bound a new regime that encouraged foreign participation in the insurance market, resulting in large capital inflows by the 144 foreign insurance companies, most of which sell life insurance. South Africa's savings and overall capital growth are directly related to the liberalization of its insurance and capital markets. The government advertised its open insurance system by referring to the fact that it is bound under international trade rules. Although internal political decision-making generated these liberalization policies, South Africa was eager to demonstrate that it was an open financial market. Making WTO commitments was part of this demonstration.

Malaysia

Malaysia's regulatory system imposes investment limitations on foreign companies, including insurance companies, in which case an insurance branch of a foreign company of no greater than 51 percent equity is allowed. (Malaysia, to our knowledge, is the only country to require the branch of a foreign insurance company to operate as a joint venture.) Malaysia is an interesting case study of a country that has considerable limitations on insurance in its GATS schedule, but whose economy has generated a considerable amount of insurance underwriting. Subsidiaries are not bound; foreign reinsurance and brokerage is not included. There are also limitations on the number of foreign personnel. Indeed, Malaysia's commitments are in line with its regulatory environment, which reflects some of these limitations (reinsurance is allowed, for instance). There are now 58 insurance companies, most of which are foreign. Malaysia's insurance market is dominated by local companies, a pattern that we see in most countries, including developing countries. Premiums were 4.9 percent of GDP, reflecting a steady rise from about half that amount in the early 1990s. Malaysia has become one of the most dynamic economies in Asia and had more success than its neighbors in withstanding the effects of the Asian financial crisis that begin in 1997. As the economy grew, insurance did as well. What Malaysia's WTO commitments mean is that its future regulatory situation remains less certain and could easily give way to more protectionist sentiments. The Doha Development Agenda provides an environment for clarifying Malaysia's WTO commitments. But Malaysia's insurance industry remained healthy and relatively competitive despite weak WTO commitments and a booming economy.

If there is a common denominator among these countries, it is that their WTO commitments reflect the regulatory situation at the conclusion of the 1997 negotiations on financial services. In a few instances, particularly for Malaysia, commitments were sometimes less than what was permitted under the regulatory system, but this was consistent with the trend of all WTO participants in these negotiations. Financial services negotiations in the WTO have not generated commitments that go beyond existing regulatory regimes. Indeed, the only country that has liberalized its financial services regime as the direct result of WTO negotiations is China, which did so upon accession to the WTO in 2001. Thus it remains to be seen whether the WTO will merely continue its role as the "grim reaper" of changes to regulation generated at the national level, or if negotiations, such as those now underway, generate liberalization. In some countries, however, the principles of liberalization in the WTO have inspired internal regulatory reform consistent with WTO principles. Frequently, forces in favor of liberalization have used the principles of financial services liberalization embodied in the GATS as leverage to bring about regulatory change. We conclude that the value of the WTO to insurance liberalization (1) ensures a more predictable regulatory environment in which foreign insurance companies can make business decisions, and (2) can inspire internal liberalization based on WTO principles in financial services.

Finance as an International Knowledge Industry

If financial services are a prime example of the knowledge-based industry identified as a high priority in Arab Human Development Report 2003: Building a Knowledge Society, it is immediately apparent that the sector in Egypt and the Middle East does not meet global standards. Egypt lacks the capacity required to meet its needs and compete globally in financial knowledge production and dissemination. The electronic dissemination of financial information and services is constrained by the low level of Internet penetration, level of education of potential retail consumers, and the number of wholesale, start-up business clients. Opportunities come from the organizational strengths of institutions in the sector, firms and regulators alike, that possess core knowledge acquisition systems increasingly focused on financial technologies, including vital training resources and international linkages.

5. Recommendations on Shaping GATS Negotiations

First, Egypt should receive credit for the significant market opening it has already accomplished, such as the opening of capital markets, the implementation of phased-in measures (such as in insurance), and unilateral liberalization steps such as the extension of custodian bank powers to foreign bank branches.

Given the high level of international interest in institutional development in emerging market financial sectors, Egypt should capitalize on the growing recognition of its financial regulatory capacities by demonstrating consistency between its domestic reform accomplishments and its evolving GATS commitments. Regulatory capacities are being matched with reinvigorated professional management in Egyptian financial firms, but full institutional capacity will not be reached without expanded investments in finance technology, communications, people, product development, and distribution networks. Attracting highly qualified direct investors who bring both equity and management techniques from leading markets, including anchor investors for restructuring, should be an integral part of Egypt's GATS strategy.

This market should expect and welcome sharper demands for market opening in the financial sector from its trading partners and use the occasion to reinforce the sense of opportunity available in the Egyptian market. Even when policymakers are not ready to make immediate commitments in areas such as form of entry, a staged or phased-in approach should be taken to show the direction and depth of Egypt's resolve to open its markets.

The potential for expanded participation by international firms should be considered carefully as an asset in the program for reforming domestic financial markets and as a tool to address immediate challenges, not just as a capstone after reforms are completed.

In formulating its GATS requests and in taking advantage of its own liberalization, Egypt should open windows for its own firms in regional markets and reinforce access points that help integrate Egyptian firms into the global network of financial sector participants.

In addition, some opportunities for Egyptian firms are not well-recognized, perhaps because of appropriate concentration on the immediate demands for domestic restructuring and reform. First, the Egyptian financial market has potential scale and diversification far beyond those of other regional economies. Second, Egyptian financial firms have great opportunities to be leaders in the Mediterranean and Middle East and to serve as informed, professional, and reliable intermediaries beyond the region.

Egypt should use GATS negotiations in financial services to show domestic and international financial markets that the country is well-advanced in making its market attractive for domestic and international investment and that it supports business and product innovation. Egypt will be seen as a market of such emerging scale and diversity that international firms with business in the region must participate.

The discussions in Sections 3 and 4 outline the kinds of requests trading partners are likely to raise with Egyptian negotiators and indicate strategies for responding with specific commitments to strengthen the domestic financial sector. It appears unlikely that the national-treatment dimension of requests and possible commitments will present much of a challenge to Egyptian policymakers. If trading partners from developed countries with leading international financial firms raise serious questions about the restricted forms of commercial presence and access available in the banking sector, it may prove timely to reconsider underlying policy assumptions if the restrictions discourage new investment and growth in the financial sector.

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Appendix. Review of GATS

General Obligations

Most-favored-nation treatment. Like the GATT, the GATS requires that a member country treat another member country no less favorably than any other member country. The GATS allows countries to take exemptions for specific measures not consistent with the MFN article. The right to take an exemption was limited to the initial round of negotiations (and for financial and telecommunications services, to the extended negotiations subsequent to the Uruguay Round), except for maritime services, for which negotiations were suspended in 1996. New member countries can negotiate MFN exemptions only as part of the accession package.

Transparency. Transparency requires that measures affecting the operation of the GATS must be published or otherwise made publicly available and extended to all services. The Services Council, the governing body of the GATS, must be notified of any such measures. Members must designate inquiry points to respond to members' questions about how specific measures will affect the operation of the agreement.

Developing countries' participation. GATS calls for developed countries to make specific commitments that will enable developing countries to strengthen domestic services capacity, efficiency, and development; improve access to distribution channels and networks; and liberalize sectors and modes of supply of specific interest to the developing country.

Economic integration. This article constitutes an exception to MFN, recognizing the preferential provisions of bilateral and plurilateral trade agreements that provide for the elimination of "substantially all" discrimination between or among the parties when there is substantial sector coverage. Other trade agreements must facilitate trade between parties and not "raise the overall level" of barriers to trade in services by other GATS signatories.

Domestic regulation. This requires that measures be administered in a reasonable, objective, and impartial manner. It gives license applicants of member countries the right to obtain information on the status of their license applications, and if a license is rejected, the right to receive an explanation for the rejection and an administrative appeal process. When a country has made specific commitments, the GATS requires that licensing requirements be based on objective and transparent criteria and not more burdensome than necessary to ensure quality of service. This obligation is qualified by the provision that the licensing requirements in question "could not reasonably have been expected" at the time the specific commitment was made. The article also calls for the negotiation of disciplines that address licensing and qualifications requirements governed, *inter alia*, by the same criteria.

Other general obligations. Other general obligations include recognition of qualifications, monopolies and exclusive services providers, business practices (competition), payments and transfers, restrictions to safeguard balance of payments, and general exceptions (similar to those incorporated in the GATT). In addition, three articles of the GATS do not impose obligations, but call for resolution of the following issues in future negotiations: inclusion of an emergency safeguard provision in services, obligations in government procurement, and whether to have rules governing subsidies.

Provisions for developing countries. In addition to the previously mentioned article on increasing developing countries' participation, provisions of other articles governing general obligations and disciplines give developing countries greater flexibility in specific circumstances. These provisions are in the articles addressing transparency, economic integration, balance of payments safeguards, and subsidies.

Specific Commitments

A specific commitment is an obligation that a country makes regarding market access and national treatment to a services sector. Member countries make specific commitments by listing the sectors and subsectors that will be subject to market access and national treatment. The positive-list approach ensures that no services sector is subject to specific commitments other than those listed in the schedule. Most, if not all, member countries have entered horizontal commitments, in which an obligation extends to all sectors. These commitments are entered as headnotes to schedules. They ordinarily cover general subsidy & investment measures and the temporary entry of natural persons.

When a member country lists a sector or subsector in its schedule of specific commitments, it is fully bound to market access and national treatment, unless it takes a reservation. Reservations concern aspects of market access and national treatment to which a country is unable or unwilling to adhere. For example, of the six elements of market access, one requires that countries not limit the number of companies in a market. A country that does limit the number of companies but conforms to the other five aspects of market access must a take reservation to market access. A member can list a reservation to undertake restrictive measures in the future, even if none exist at the time of the scheduling process. Reservations are entered according to each of the modes of supply.

Market access is defined in terms of measures: limitations on the number of service suppliers, limitations on the total value of service transactions or assets, limitations on the total number of service operations or on the total quantity of service output, limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ, measures which restrict or require specific types of legal entity or joint venture, limitations on the participation of foreign capital

National treatment means that a member country will extend treatment to other members on terms that are no less favorable than the treatment it gives to its own services or services suppliers. A national treatment violation occurs when a measure, although it might treat foreign and host country services identically, modifies the "conditions of competition" in favor of host country services.

The GATS recognizes the conceptual and legal overlap between many aspects of market access and national treatment (Article XX.2). For example, joint venture requirements are both discriminatory and inconsistent with the provisions of market access, and a reservation for market access is considered a reservation for national treatment as well.

Additional commitments are any commitments that are not covered by the provisions of market access and national treatment. They generally cover nondiscriminatory regulation, especially with respect to licensing and qualification. The most prominent example of an additional commitment concerns the interconnection of basic telecommunications networks.

Progressive liberalization. Article XIX, Negotiation of Specific Commitments, outlines the general aims and goals of future negotiations and calls for "achieving a progressively higher level of liberalization." It requires the establishment of procedures and guidelines for each round of negotiating as well as an assessment of trade in services generically and on a sector-specific basis. In addition, it states, "There shall be appropriate flexibility for individual developing country members for opening fewer sectors, liberalizing fewer types of transactions, progressively extending market access in line with their development situation."

The GATS also includes an article that addresses the modification of schedules by countries when it becomes necessary to reduce the level of a commitment. Guidelines pursuant to this article govern procedures used when countries must resort to arbitration.

Final provisions. The GATS incorporates provisions for consultation, dispute settlement, and enforcement of the agreement. These provisions are in conformity with the WTO's Dispute Settlement Understanding.

In addition to administrative provisions, such as the creation of the Council for Trade in Services, the GATS contains provisions that address the denial of benefits to nonmembers, as well as definitions of terms.

Annexes

The GATS contains a number of annexes that address the movement of natural persons, air transport services, telecommunications, and financial services, among other things. Annexes are an integral part of the GATS.

The annex on financial services specifies the activities that constitute "services in the exercise of government authority." It makes an exception to the general obligations, stating that a member "shall not be prevented from taking measures for prudential reasons, including the protection of investors, depositors, policy holders or persons to whom fiduciary duty is owed, or to ensure the integrity and stability of the financial system." But it also states that no such prudential measure can be used as a means of avoiding a member's commitments under the GATS. This "prudential carve-out" is broad in design and scope, taking into account the fact that financial regulators generally treat foreign services providers less favorably than domestic ones. For example, larger capital requirements are imposed on foreign financial institutions than on their domestic counterparts. Commentators have questioned whether such a broad exemption might cover other practices, such as a freeze on the number of new financial enterprises in a host country, and other practices that might take the form of disguised protection. The broad sweep of the prudential exception provides little guidance on these matters, and thus far members have resisted efforts to interpret the carve-out.

In addition, the financial services annex requires that members of dispute resolution panels for prudential issues and other financial services matters have expertise relevant to the specific financial service that is being disputed.

The annex excludes public entities from the definition of "financial services supplier," defining them as "government, a central bank, or a monetary authority" carrying out governmental functions, but not including entities carrying out financial services on commercial terms, or any private entity that carries out those same functions. Similarly, private entities carrying out the same responsibilities as central banks are regarded as public entities and, by inference, not subject to the disciplines of GATS.

Finally, the Financial Services Annex contains definitions that have served as nomenclature for scheduling of financial services commitments.